

Message Text

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DEPT PASS FRB, TREAS, COMMERCE

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SUBJECT: EDRC REVIEW OF SWITZERLAND

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1. SUMMARY. AT SWISS EDRC REVIEW FEBRUARY 7, SWISS MADE CLEAR FIRST PRIORITY IN 1974 WILL BE CONTROL INFLATION VIA MONETARY, BUDGETARY AND EXCHANGE RATE POLICIES. OIL PRICE RISE NOT EXPECTED HAVE SERIOUS DEPRESSIVE EFFECTS ON ECONOMY, EXCEPT POSSIBLY THROUGH REDUCED DEMAND FOR EXPORTS FROM TRADITIONAL TRADING PARTNERS. GNP EXPECTED RISE ONLY 2 PERCENT IN 1974, AND BALANCE PAYMENTS CURRENT ACCOUNT EXPECTED SHOW SMALL DEFICIT. IN INTEREST DOMESTIC PRICE STABILITY, SWISS INTEND DISCOURAGE OIL-RELATED CAPITAL REFLOWS. END SUMMARY.

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2. OUTLOOK FOR DEMAND AND OUTPUT. SWISS EXPECT SLACKER DEMAND IN 1974, EXPECIALLY IN BUILDING SECTOR AND PERHAPS IN EXPORT MARKETS. PRIVATE CONSUMPTION EXPECTED RISE BY 3.5 PERCENT, AND MINIMUM GROWTH GNP WILL BE ABOUT 2 PERCENT. SECRETARIAT AND US REP CHALLENGED EXPECTATION THAT 2 PERCENT WILL BE MINIMUM GROWTH LEVEL, IN VIEW UNCERTAIN PROSPECTS FOR DOMESTIC AND FOREIGN DEMAND RESULTING FROM OIL PRICE INCREASES. BARRING CHANGE TO MORE STIMULATIVE POLICIES, SECRETARIAT CONSIDERED 2 PERCENT BE MAXIMUM, NOT MINIMUM.

3. SWISS ADMITTED SOME VULNERABILITY TO EXPECTED FALL OFF IN EXPORT DEMAND SECOND HALF 1974, BUT NOTED STRENGTH PRESENT EXPORT ORDER BOOKS AND LIKELIHOOD THAT OIL SUPPLY SHORTAGES CAN BE ACCOMMODATED WITHOUT AFFECTING PRODUCTION LEVELS. THEY ALSO EMPHASIZED FLEXIBILITY OF POLICY STANCE IN EVENT INCREASING WEAKNESS IN DEMAND AND SAID THEY WERE PREPARED RELAX RESTRICTIONS ON CONSTRUCTION SECTOR AND ACCELERATE PUBLIC WORKS PROGRAM IF NEED FOR STIMULATION APPARENT. HOWEVER, POLICIES WOULD BE GUIDED BY PRIMARY NEED MAINTAIN PRICE STABILITY. SWISS DID NOT ADDRESS THEMSELVES DIRECTLY TO POSSIBLE DEPRESSIVE EFFECTS INCOME LEAKAGE DUE TO OIL PRICE RISES. GERMANS SUPPORTED OPTIMISTIC SWISS OUTLOOK BY NOTING THAT THEY HAD ALSO REVISED GROWTH EXPECTATIONS UPWARDS IN RECENT WEEKS.

4. EMPLOYMENT. SWISS DEL NOTED THAT EMPLOYMENT LEVELS HAD NOT BEEN SIGNIFICANTLY AFFECTED BY PREVIOUS SLOWDOWN IN GNP GROWTH, AND WITH PRESENT TIGHT LABOR MARKET CONDITIONS, THERE WAS LITTLE RISK UNEMPLOYMENT IN 1974. SLACK IN ACTIVITY COULD BE ABSORBED BY REDUCTIONS IN OVERTIME, AND IT WAS UNLIKELY THAT FOREIGN LABOR FORCE WOULD BE AFFECTED.

5. PRICES AND WAGES. SWISS SAW INFLATION AS MAIN LIMITED OFFICIAL USE

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DANGER FACING ECONOMY IN 1974. INFLATION RATE WILL NOT RISE AS FAST IN 1974 AS IN 1973 SINCE MAJOR PART OF OIL PRICE RISES ALREADY REFLECTED IN VERY RAPID FOURTH QUARTER 1973 FIGURES. EDRG SOMEWHAT SKEPTICAL ABOUT SWISS CLAIM THAT PRICES WILL RISE ONLY 8 TO 10 PERCENT IN 1974, IN VIEW OF 1973 INCREASE OF 11.9 PERCENT AND FOURTH QUARTER 1973 RATE OF OVER 20 PERCENT ON ANNUAL BASIS. COMMITTEE NOTED

SWISS HAD NOT YET TAKEN INTO ACCOUNT BOTH DIRECT AND INDIRECT EFFECTS DECEMBER 25 OIL PRICE RISE WHICH WOULD BE REFLECTED IN 1974 FIGURES. SWISS SAID IMPORT PRICE RISES SHOWED UP QUICKLY IN CONSUMER INDEX, AND 1973 FIGURES ALREADY CONTAINED LARGE OIL RELATED INCREMENT. CONSTRUCTION PRICES WERE LEVELING OFF AND DEMAND PRESSURES WOULD BE LESS STRONG IN 1974, ESPECIALLY IN SECOND HALF. NOMINAL WAGES EXPECTED RISE ABOUT 10 TO 12 PERCENT, BUT WAGE DRIFT WILL BE REDUCED DUE SLOWDOWN ECONOMY. PASS THROUGH OF WAGES WILL BE DISCOURAGED BY PRICE SURVEILLANCE MEASURES AND BY SQUEEZE IN COMPANY PROFITS CAUSED BY INCREASING COMPETITIVE PRESSURES IN EXPORT AND DOMESTIC MARKETS. SWISS FELT SECRETARIAT TOO PESIMISTIC ON PRICE OUTLOOK AND ASKED THAT PARAS 44 AND 45, REF. C, BE REVISED TO PRESENT MORE BALANCED PICTURE.

6. ANTI-INFLATION POLICY. SWISS WILL PLACE MAIN EMPHASIS ON MONETARY, BUDGETARY AND EXCHANGE RATE POLICIES TO CONTROL INFLATION. MONETARY POLICY HAD PROVED ITS EFFECTIVENESS, AND LIQUIDITY WAS TIGHT. INTEREST RATES WILL REMAIN LOW TO DETER INFLOWS OF FOREIGN FUNDS, AND SWISS WILL ATTEMPT RECYCLE ANY OIL RELATED CAPITAL REFLOWS. CONTINUED FLOATING EXCHANGE RATE ALSO EXPECTED BE DETERRENT TO POTENTIAL INVESTORS. SWISS DO NOT SEE REASON STIFFEN SURVEILLANCE OVER PRICES AND INCOMES AS LONG AS SYSTEM OF CONSULTATION WITH SOCIAL PARTNERS RESULT IN COOPERATION. AUTHORITY FOR BROADER POWERS OVER PRICES AND INCOMES WOULD HAVE TO COME FROM ELECTORATE, AND UNIONS HAVE ALREADY INDICATED OPPOSITION TO INCREASED FEDERAL LIMITED OFFICIAL USE

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POWERS THIS AREA.

7. U.S. REP RAISED QUESTION REGARDING EFFECTS MONETARY RESTRAINT ON BANK LIQUIDITY AT TIME WHEN OIL PRICE INCREASE LIKELY CAUSE FURTHER LEAKAGE FROM DOMESTIC INCOME STREAM. RESULTS WOULD BE SIMILAR TO INCREASED TAXATION, AND WOULD EFFECTIVELY MAKE LIQUIDITY EVEN TIGHTER THAN AT PRESENT. SWISS

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REPLIED THEY WOULD RELAX BANKS MINIMUM ASSETS REQUIREMENTS, AND RESPOND APPROPRIATELY WITH FLEXIBLE POLICY STANCE. THEY DID NOT COMMENT ON POSSIBLE DESIRABILITY PERMITTING CAPITAL INFLOWS FROM ABROAD TO RESTORE LIQUIDITY POSITION OF BANKS.

8. BALANCE OF PAYMENTS. SWISS EXPECT SMALL DEFICIT ON CURRENT ACCOUNT AFTER CALCULATING IMPACT OF HIGHER OIL PRICES ON TRADE BALANCE. EXPORT VOLUME EXPECTED GROW BY 5.5 PERCENT AND IMPORTS BY 4 PERCENT. OIL IMPORTS MAY COST \$350 TO \$700 MILLION MORE IN 1974, BUT SWISS NOT PARTICULARLY CONCERNED ABOUT IMPACT ON BOP AT TIME WHEN FX RESERVES ARE STRONG. BECAUSE OF THEIR CONCERN OVER INFLATION, SWISS DO NOT INTEND FINANCE CURRENT ACCOUNT DEFICITS BY ENCOURAGING CAPITAL REFLOWS FROM OPEC COUNTRIES, AND SWISS DEL ASKED SPECIFICALLY THAT SECRETARIAT REVISE PARA 45 REFDOK TO REFLECT THIS. THEY WERE ALSO CONCERNED THAT CAPITAL INFLOWS MAY CAUSE

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EXCESSIVE UPWARD FLOAT OF FRANC, AND INDICATED

CENTRAL BANK MIGHT HAVE TO INTERVENE ON EXCHANGE
MARKETS TO PROTECT EXPORT COMPETITIVENESS.

9. PUBLIC FINANCE AND FISCAL POLICY: SWISS DIS-
CUSSED THREE AIMS OF FISCAL REFORM: FIRST IS TO
REPLACE PRESENT TURNOVER TAX WITH MORE BROADLY
BASED VALUE ADDED TAX. PROPOSAL WILL BE SUBMITTED
TO ELECTORATE IN FORM OF CONSTITUTIONAL AMENDMENT
(ARTICLE 31) IN 1975. SECOND MAJOR REFORM IS
PROPOSED CHANGE IN METHOD OF FEDERAL INCOME TAX
ASSESSMENT FROM PRIOR YEAR BASIS TO PAY AS YOU EARN
(PAYE) SYSTEM. THIRD REFORM WILL BE CONTINUED
EFFORTS HARMONIZE FEDERAL AND CANTONAL REVENUE
AND EXPENDITURE SYSTEMS TO REMOVE INEQUITIES IN
TAX COVERAGE AND IMPROVE COORDINATION OF FISCAL
POLICIES. CONSULTATION WITH CANTONS HAS ALREADY
RESULTED IN ACCEPTANCE BY CANTONS OF CERTAIN
BUDGETARY MORMS.

10. US REP ASKED WHY SWISS WERE CONSIDERING INTRO-
DUCTION OF REGRESSIVE VAT RATHER THAN INCREASE IN
MORE PROGRESSIVE INCOME TAX. SWISS REPLIED THAT
FEDERAL AUTHORITIES COULD NOT ENCROACH FURTHER ON
CANTONAL TAX BASE WITHOUT SIGNIFICANT RESISTANCE.
US DEL ALSO ASKED, PER REF B, WHETHER IT WOULD BE
IN SWISS INTEREST DEPART FURTHER FROM FREE MARKET
ECONOMY BY EXPANDING FEDERAL SCOPE FOR INTERVENTION.
SWISS REPLIED THEIR COUNTRY WAS "ALLERGIC TO
IDEOLOGY" AND STILL BELIEVED IN MARKET SYSTEM,
BUT UPSETTING EVENTS OF 1971 AND UNACCUSTOMED IN-
FLATIONARY PRESSURES REQUIRED TEMPORARY DEPARTURES
FROM TRADITIONAL PRACTICE. SWISS DEL DID NOT COMMENT
DIRECTLY ON PROPOSED CONSITUTIONAL AMENDMENT WHICH
WOULD PROVIDE PERMANENT AUTHORITY TO INTERVENE IN
ECONOMYBROWN

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